



# North Carolina's Approach To SUTA Dumping



Employment Security Commission of North Carolina

# UI Tax Alert

For Immediate Release: February 24, 2003

## State Unemployment Tax Avoidance (SUTA Dumping)

The Employment Security Commission (ESC) has become increasingly aware of the practice of State Unemployment Tax Avoidance (also called "SUTA dumping") in North Carolina. The agency has also learned that certain tax advisory companies are promoting this activity as a way of gaining business by promising potential clients reduced expenses and increased profits.

The ESC will actively pursue and prosecute employers engaged in this activity and has the authority to subpoena records and individuals in its investigations.

SUTA cases, a and def

Employer returns a

tax documents in order to reduce unemployment taxes. This practice is in violation of N.C. G.S. 96-13.1, which states that any person who knowingly makes false statements and omits material information in order to obtain unemployment benefits is guilty of a Class 1 misdemeanor. The statute of limitations for this offense is three years.

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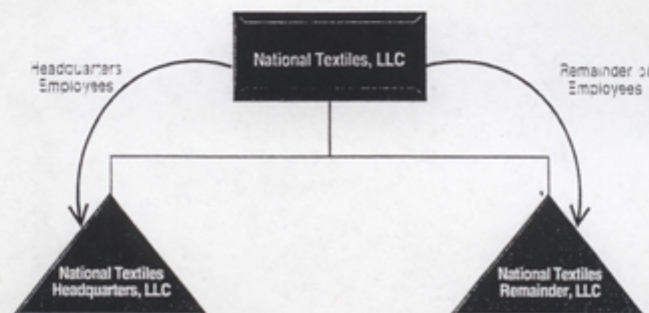




## Potential Strategies & Benefits

### Strategy 1

#### Implement Employee Split



#### How Benefits are Achieved

- National Textiles separates its employees, in addition to selected assets, into National Textiles Headquarters, LLC and National Textiles Remainder, LLC
- Segmenting headquarters employees from the remainder of the employees allows the company to separate itself from high unemployment tax experience history and obtain short-term savings and recurring savings
- The LLCs will be disregarded for federal and most state income tax purposes





## Team Experience

### We Have Recent, Direct Experience on Similar Projects for Other Companies

Members of our team have developed and implemented similar planning strategies for other organizations. Within the last three years our team has been involved in numerous SUTA planning projects including the following:

- *\$30 million. More than \$30 million of savings for a large temporary services company through consolidation of a number of legal entities and the utilization of an entity rotation strategy.*
- *\$6.4 million. Virginia based processor reduced unemployment taxes by over \$6.4 million by implementing strategies to obtain new and minimum employer rates.*
- *\$3.8 million. Virginia based processor reduced unemployment taxes by over \$3.8 million by implementing strategies to consolidate entities and obtain minimum employer rates.*
- *\$1.4 million. North Carolina based company reduced unemployment taxes by over \$1.4 million by implementing strategies to obtain new employer rates.*
- *\$1.2 million. North Carolina construction company saved over \$1.2 million by utilizing strategies to obtain new employer and minimum unemployment tax rates.*
- *\$1 million. North Carolina based construction company saved over \$1 million by implementing strategies to obtain minimum unemployment tax rates.*
- *\$800 thousand. North Carolina textile company utilized strategies to obtain the minimum rate in Ohio that produced \$800 thousand of savings.*
- *\$1.4 million. Over \$1.4 million first year savings and \$200,000 residual savings for a large national retailer by consolidating their number of individual tax entities from 625 to 48 while exercising favorable successor electives.*
- *\$375,000. For a New York manufacturer that acquired 16 plants and 1,500 employees from a competitor, but did not exercise all favorable successor rights, gained FICA, FUTA and SUTA refunds totaling more than \$375,000.*
- *\$1.1 million. Over \$1 million of state unemployment tax savings for a Kentucky based manufacturer, by isolating a continuing plant from the unemployment backlash caused by the closing of another.*
- *\$2.4 million. Illinois state unemployment tax savings for a Connecticut based manufacturer by segmenting distinct operating divisions into separate new entities.*
- *\$350 thousand. Illinois state unemployment tax savings for an Alabama based mining operation by tweaking their restructuring plan in a way that triggered state unemployment savings.*
- *\$1.35 million. Texas state unemployment tax refund for a Maryland based staff leasing company where they reorganized their operations and had not exercised all favorable successor employer electives.*

# SUTA DUMPING LOG

As of April 8, 2005

	TAX DUE	TAX PAID	INTEREST AND PENALTIES DUE	INTEREST AND PENALTIES PAID	TOTAL DUE	TOTAL COLLECTED
\$	18,142.37	\$ 18,142.37	\$ 9,158.27	\$ -	\$ 27,300.64	\$ 18,142.37
\$	392,460.15	\$ 392,460.15	\$ 145,002.45	\$ -	\$ 537,462.60	\$ 392,460.15
\$	472,244.91	\$ 472,244.91	\$ 114,982.73	\$ -	\$ 587,227.64	\$ 472,244.91
\$	467,749.58	\$ 467,749.58	\$ 123,665.31	\$ -	\$ 591,414.89	\$ 467,749.58
\$	1,303,993.82	\$ 1,212,518.00	\$ 538,572.03	\$ -	\$ 1,842,565.85	\$ 1,212,518.00
\$	801,891.09	\$ 250,480.63	\$ 333,964.51	\$ -	\$ 1,135,855.60	\$ 250,480.63
\$	680,829.66	\$ 680,829.66	\$ 304,858.02	\$ -	\$ 985,687.68	\$ 680,829.66
\$	64,565.56	\$ 64,565.56	\$ 90,776.11	\$ -	\$ 155,341.67	\$ 64,565.56
\$	797,863.87	\$ 797,863.87	\$ 272,003.44	\$ -	\$ 1,069,867.31	\$ 797,863.87
\$	310,794.13	\$ 310,794.13	\$ 149,518.36	\$ -	\$ 460,312.49	\$ 310,794.13
\$	1,723,843.49	\$ 1,300,000.00	\$ 721,063.48	\$ -	\$ 2,444,906.97	\$ 1,300,000.00
\$	2,590,714.82	\$ 1,187,878.77	\$ 1,367,286.79	\$ -	\$ 3,958,001.61	\$ 1,187,878.77
\$	27,885.50		\$ 8,595.43		\$ 36,480.93	
\$	1,154,536.70		\$ 475,530.53		\$ 1,630,067.23	
\$	272,888.31	\$ 272,888.31	\$ 66,135.86	\$ -	\$ 339,024.17	\$ 272,888.31
\$	401,735.39	\$ 361,735.39	\$ 221,127.33	\$ -	\$ 622,862.72	\$ 361,735.39
\$	1,009.82	\$ 1,009.82	\$ 502.56	\$ -	\$ 1,512.38	\$ 1,009.82
\$	580,180.74	\$387,765.44	\$ 92,559.37	\$ -	\$ 672,740.11	\$ 387,765.44
\$	340,159.92	\$ 100,000.00	\$ 119,571.02	\$ -	\$ 459,730.94	\$ 100,000.00
\$	121,609.49	\$ 121,609.49	\$ 40,262.60	\$ -	\$ 161,872.09	\$ 121,609.49
\$	570,749.42	\$ 570,749.42	\$ 100,762.08	\$ -	\$ 671,511.50	\$ 570,749.42
\$	5,698.11	\$ 5,698.11	\$ 4,184.12	\$ -	\$ 9,882.23	\$ 5,698.11
\$	10,290,839.50		\$ 4,458,119.64		\$ 14,748,959.14	
\$	4,013,161.96	\$ 1,900,000.00	\$ 2,240,390.28	\$ -	\$ 6,253,552.24	\$ 1,900,000.00
\$	45,987.99		\$ 5,558.99		\$ 51,546.98	
\$	59,799.20	\$ 30,000.00	\$ 35,645.08	\$ -	\$ 95,444.28	\$ 30,000.00
\$	1,548.62		\$ 2,006.18		\$ 3,554.80	
\$	2,160.00		\$ 1,036.96		\$ 3,196.96	
\$	723,752.73		\$ 592,080.29		\$ 1,315,833.02	
\$	130,818.06		\$ 20,291.45		\$ 151,109.51	
\$	351,625.10		\$ 177,708.61		\$ 529,333.71	
\$	220,021.86		\$ 95,812.86		\$ 315,834.72	
<b>TOTALS</b>	\$ 28,941,261.87	\$ 10,906,983.61	\$ 12,928,732.74	\$ -	\$ 41,869,994.61	<b>\$ 10,906,983.61</b>

# North Carolina SUTA Law

- Our notion of an employer is fixed by the statutory “common law term” employment defined as being the “legal relationship of employer and employee”
- Our new continuity of control statute changes nothing. It maintains law.
  - **NC won't give dependent spinoffs status as independent UI employers**
- Continuity of control exists where same actors change business formats

# Penalties

- 50% fraud penalty on tax due for intent to evade
- Attempt to evade or defeat Tax Class H felony
- Aiding, assisting, counseling, preparing, procuring a false filing is also Class H felony.

# “The Numbers Today” (August 2005)

- 58 in field
- Potential awaiting investigation (90)
- Collected → 12,000,000 (+)
- In negotiation → 20,000,000 (+)
- Projected → 28,000,000 (+) on  
(28) of the (90)



# “The Process”

- Detection
- Prioritize
- Investigate
- Post-Investigative Conference
- Negotiate/Settle/Assess
- Litigation

# “Forensic Prep”

- Gather sufficient documentation
- Leave “no stone unturned” during the interview
- Do not forget about the e-mails and internal memos
- During post conferences, ask attorneys and principals for comments
- Focus on our responsibility (do not waiver)

# Employers & Their Dream Teams

- “We had a real business purpose”
- “Other governmental authorities condone our actions”
- “The Unions require this”
- “We need to have separate accounting for possible litigation or sale”
- “It is not real money”



## Employment Security Commission of North Carolina

*Post Office Box 26504 Raleigh, North Carolina 27611 (919) 733-3121*

**Michael F. Easley**  
*Governor*

August 6, 2004

**Harry E. Payne, Jr.**  
*Chairman*

Employer  
Address  
City State

RE: Account Number: 12-34-567

The Employment Security Commission has concluded its review of your compliance with the reporting requirements of Chapter 96 of the General Statutes of North Carolina. The investigation revealed discrepancies that appear inconsistent with the provisions of the Employment Security Law of North Carolina.

If you would like to discuss the investigation, please request a conference within 15 days of this letter. If a request is not received as mentioned above, a written report will be sent to you to include an assessment of any additional tax, interest and penalties due.

If you have any questions please do not hesitate to call me at (919) 733-7396.

Sincerely,

W. T. Brinn, Jr.  
Field Tax Operations Manager  
Unemployment Insurance Division

# SUTA Dumping – Field Investigations

## Basic Strategy

- Arrange Meeting with Decision Makers (phone contact)
- Ask for documents to be made available at initial meeting
- Team of two experienced auditors meet with principals to gather information
- Information and documents discussed with Tax Management
- Follow-up meeting with principals to discuss findings
- Formal internal report prepared by auditors for Tax Management
- Customized assessment letter generated, approved, and mailed to employer



# SUTA Dumping – Field Investigations

## Requested Documents

- Bill of Sale
- Description of assets acquired
- Corporate minutes describing the formation of the LLC's
- Federal Forms: 940, 941 W-2's, W-3, 8832, SS4 (as relevant after formation)
- Notice of coverage of Workman's Comp.
- Notice of fringe benefits to include health, life and retirement
- Income tax return
- Rent agreements, leases
- Bank account names and numbers for payroll and operating expenses
- Any management agreements between LLC's and parent equipment leases
- **NOTE:** Documentation related to advisors and consultants are verbally requested at initial meeting (possible subpoena later)





# SUTA Dumping – Field Investigations

## Basic Interview Questions

- **Why have you set up these entities?**
- **Are these entities disregarded for income tax purposes?**
- **(if appropriate) Describe how these entities are a distinct and severable portion of the former company**
- **What company names are shown on invoices, payroll checks, bank accounts, et cetera?**
- **Can these LLC's or related establishments/divisions obtain bank loans, etc. independently?**
- **What FID#'s are being used by the various entities?**
- **Under what entities are income tax and quarterly payroll taxes (other than SUTA), being reported?**
- **How was the percentage of transfers, if applicable, determined? How does this percentage relate to the workforce now and in the projected future?**



## **Basic Interview Questions - continued**

- **Are retirement and fringe benefit packages handled differently related to the change in structure?**
- **How is the workforce being reported now?**
- **Are there plans to change this reporting?**
- **Do workers know about this entity change?**
- **Why are you doing this?**
- **Who advised you to do this?**



FRIDAY, JULY 9, 2004

▼ **DOW**  
68.73 at 10,171.56

▼ **NASDAQ**  
30.76 at 1,935.32

▼ **AMEX**  
2.52 at 1,255.05

▼ **NYSE**  
45.33 at 6,473.58

▼ **S&P 500**  
9.22 at 1,109.11

▼ **10-YEAR NOTE YIELD**  
4.472%, down from 4.476%

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go to [www.newsobserver.com/stocks](http://www.newsobserver.com/stocks).

# Business

## ESC releases tax documents

*Says dummy corporations avoided tax*

By AMY MARTINEZ  
STAFF WRITER

As the state's unemployment insurance trust fund was going broke in November 2001, accounting firm Deloitte & Touche held meetings in North Carolina to show businesses how to set up shell corporations to lower their unemployment taxes, according to the state.

Documents released Thursday by the Employment Security Commission provide new details of how some of the nation's biggest accounting firms taught companies the complicated accounting scheme known as State Unemployment Tax Act avoidance, or SUTA dumping.

Deloitte & Touche, for example, promised one business that it would save as much as up to \$7.2 million in five years.

Deloitte & Touche, which commanded hundreds of thousands of dollars for its consulting services, used diagrams to show the business that the high unemployment taxes it was paying because of past layoffs could be reduced by moving its employees to one or more limited liability companies.

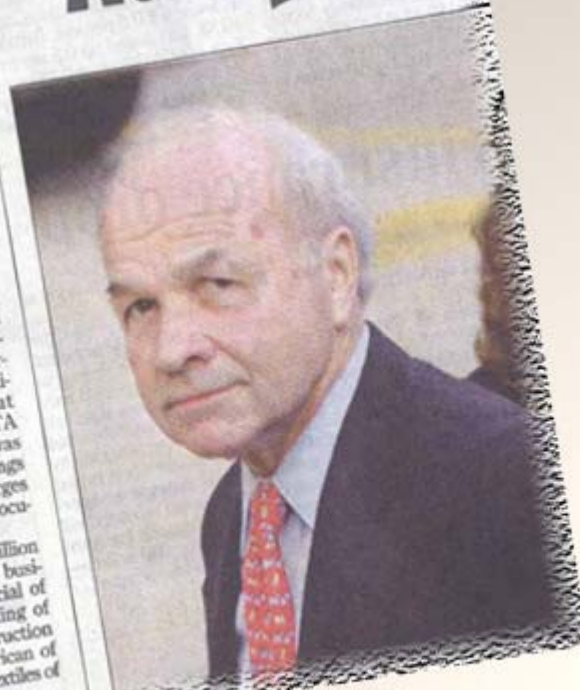
### HOW SUTA DUMPING WORKS:

A business forms one or more limited liability corporations. The companies then are given a lower "new business" tax rate. It transfers its employees to those companies, usually over several years.

The commission said it is investigating Deloitte & Touche, as well as other accounting and law firms. The documents, which were released at the request of The News & Observer and other newspapers, included tax filings and correspondence between state auditors and five businesses that settled disputed claims of SUTA dumping. The business that was promised \$7.2 million in savings did not protest the state's charges and was not named in the documents.

The state collected \$3.2 million in back taxes from the five businesses: Standard Commercial of Wilson; Mega Force Staffing of Fayetteville; Blythe Construction of Charlotte; Coats American of Charlotte; and National Textiles of

## Enron's cl Adelphia



  
**ESC**

# Questions

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- 919-733-7396 ext 201